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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1947

No.

JAMES F. WATERS, INC. (a corporation),
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit.

To the Honorable Fred M. Vinson, Chief Justice of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

The petition of James F. Waters, Inc., a California corporation, hereinafter usually called "petitioner" respectfully petitions this Honorable Court for a re-

view on writ of certiorari of the decision of the United States Circuit Court of Appeals for the Ninth Circuit in James F. Waters, Inc., a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent, and numbered 11,252 therein.

SUMMARY AND SHORT STATEMENT OF THE MATTER INVOLVED.

James F. Waters, an individual, hereinafter usually called "decedent," was an automobile dealer and distributor. He incorporated James F. Waters Securities Corp., hereinafter usually called "Securities," in 1932 (R. 89) to finance the cars he sold. He incorporated petitioner in 1934 (R. 89) and it took over his operations as an automobile dealer and distributor. He was petitioner's president and chief shareholder until his death.

From 1924 to 1934 decedent procured eight life insurance policies on his life aggregating in face amount \$147,000.00.[1] (R. 96.) These policies were transferred to Securities about April 26, 1935. (R. 90.) At that time decedent was paid by Securities therefor[2] \$6,222.32, the cash surrender value of the policies transferred less the 1935 premiums due thereon.[2] (R. 90.) Securities paid the premiums due on all of the policies so transferred from 1935 to 1938, both inclu-

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[1]Two policies the proceeds of which are not involved are omitted here and elsewhere in the interest of brevity.

[2]Two of the policies had no cash surrender value and there is a question whether they were transferred for a valuable consideration; detail is omitted here in the interest of brevity.

sive. On or about October 31, 1938, Securities merged with petitioner and there was then transferred to petitioner by operation of law all of said policies.

Neither petitioner nor Securities recognized any gain or loss upon said transfer. (R. 94.)

Thereafter petitioner failed to pay the premiums due on any of said policies other than on one term group policy, premiums on which it continued to pay until decedent's death. (R. 93-98.)

The terms and conditions of each of said policies differ somewhat but in effect the result of the failure to pay the premiums due in 1939 caused the policies to lapse and the then cash surrender value of each of the policies was applied to the purchase of term insurance for the principal amount of the original policy for a term computed pursuant to the provisions of the respective insurance policies. At the expiration of such respective terms, the insurance became void. (R. 99-188.)

The decedent died on May 10, 1941, before the expiration of such term insurance and the petitioner received the sum of $141,693.77 as the proceeds of such term insurance. (R. 96.)

At the time of decedent's death petitioner owned the controlling interest in a Michigan corporation and a New York corporation. (R. 84.) This Michigan corporation manufactured Skyview cabs. (R. 84.) The New York corporation sold cabs manufactured by the Michigan corporation and also sold De Soto and Plymouth automobiles in New York. (R. 84.) Peti-

tioner then sold new and used cars at retail in San Francisco and distributed new cars at wholesale to 56 dealers in Northern California. (R. 84.)

Almost immediately following decedent's death disputes arose between petitioner and his widow. (R. 85.) In settlement of these disputes and the litigation arising therefrom petitioner paid the widow approximately $355,000 and transferred to her an improved piece of real estate. (R. 86.) Pursuant to the settlement agreement petitioner paid $57,500 to others as well as furnishing funds in excess of $100,000 to the estate.[3] (R. 86.)

Petitioner did not include any portion of the proceeds of the life insurance policies in its income in its federal income tax return for 1941, because they were exempt from taxation under IRC 22(b)(1).[4]

Respondent asserted that $106,967.56[5] of the proceeds should have been included in petitioner's gross income for 1941 and asserted deficiencies as follows:[5]

$21,000.71	in income taxes
3,732.42	in declared value excess profits taxes
36,197.25	in excess profits tax. (R. 36.)

---

[3]This is exclusive of debts decedent owed petitioner and its New York subsidiary.

[4]IRC 22(b)(1) reads as follows:

"(b) *Exclusions From Gross Income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(1) *Life Insurance.*—Amounts received under a life insurance contract paid by reason of the death of the insured."

[5]These are the figures resulting from respondent's amended answer rather than the original deficiency letter. The difference between the two is not now material.

Petitioner before the Tax Court and before the Circuit Court of Appeals not only claimed that under IRC Section 22(b)(1) the entire proceeds were exempt from taxation but that the proceeds were abnormal income under IRC Section 721, and as such, for purposes of the excess profits tax law, were attributable to prior years. Both the Tax Court (R. 39 et seq.) and the Circuit Court of Appeals (R. 286 et seq.) held that the life insurance proceeds were not exempt from taxation.

The Tax Court held that the life insurance proceeds were abnormal income but that no part thereof was attributable to prior years. (R. 50-51.) The Circuit Court of Appeals held (R. 290-293) that it was without jurisdiction to review the decision of the Tax Court on the phase because the Congress had provided in Section 732(c) that the determination of any question which was necessary solely by reason of Section 721 could not be reviewed by any Court or agency except the Tax Court.

THE BASIS UPON WHICH THE SUPREME COURT HAS JURISDICTION TO REVIEW THIS CASE.

Section 240 of the Judicial Code, as amended, 26 Stat. 828, Ch. 517, § 6, as amended, 36 Stat. 1157, Ch. 231, § 240, 43 Stat. 938, Ch. 229, § 1, Title 28, U.S.C.A. § 347, grants to this Court jurisdiction to require by certiorari, that this cause be certified to it for determination by this Court.

Judgment of the Circuit Court of Appeals for the Ninth Circuit was entered on March 19th, 1947. The petition for rehearing was timely filed by petitioner on April 18th, 1947 and on April 25th, 1947, there was entered the order of the Circuit Court of Appeals of the Ninth Circuit denying the petition for a rehearing. (R. 293-294.)

The time for filing petition for certiorari to this Court runs from said last mentioned date.

> 26 Stat. 828, Ch. 517, § 6 as amended, 39 Stat. 727, Ch. 448, § 6, 43 Stat. 940, Ch. 229, § 8, Title 28, U.S.C.A. § 350.

See:

> *U. S. v. Ellicott,* 223 U.S. 524, 32 S.Ct. 334;
>
> *Aspen Mining & Smelting Co. v. Billings,* 150 U.S. 31, 14 S.Ct. 4;

and

> *Commissioner of Internal Revenue v. Bedford's Estate* (1945), 325 U.S. 283, 65 S.Ct. 1157.

THE QUESTIONS PRESENTED.

First: Whether the Congress can deprive petitioner of his day in Court on a question of law arising under Section 721 of the Internal Revenue Code in violation of Article III of the Constitution, which vests the judicial power in the Supreme Court and in such inferior Courts as the Congress may from time to time establish.

Second: Whether any portion of the life insurance proceeds are attributable to prior years in computing petitioner's excess profits taxes.

Third: Whether all the life insurance proceeds are exempt from taxation,

(a) because the proceeds are exempted by Section 22(b)(1) of the Internal Revenue Code;

(b) because the proceeds did not compensate petitioner for the loss it sustained upon decedent's death; and

(c) because the proceeds were not income under the Sixteenth Amendment.

THE REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. Section 732(c) of the Internal Revenue Code[6] deprives all taxpayers of any day in any Court on any question arising under Section 721. Whether this violates Article III of the Constitution is an important question of federal law which has not been, but should be settled by this Court; it is a question which will affect hundreds, if not thousands, of cases involving millions of dollars, if not hundreds of mil-

[6]Sec. 732(c) FINALITY OF DETERMINATION. If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of * * * section 721 * * * the determination of such question shall not be reviewed or redetermined by any court or agency except the Board. (* * * indicate the omission of other sections not here involved.)

lions, of federal revenues;[7] it involves taxes the effective rate of which went as high as 85½%.

2. The Circuit Court of Appeals in holding that it was without jurisdiction to review excess profits tax questions has decided a federal question in a way probably in conflict with applicable decisions of this Court, e.g., the executive cannot exercise judicial power[8], the interpretation of statutes is exclusively a judicial function[9] which cannot be circumscribed by the legislature[10]. Nor may an executive agency finally decide the limits of its statutory power; that is a judicial function[11].

3. The Circuit Court of Appeals in holding that it was without jurisdiction to review the excess profits tax questions involved has so far departed from the accepted and usual course of judicial proceeding as to call for an exercise of this Court's power of super-

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[7]Respondent can inform the Court more fully than petitioner as to number of cases and amounts which may be involved under Section 732 as applied to 721.

[8]*Springer v. The Philippine Islands* (1928) 277 U.S. 189, 72 L. Ed. 845.

[9]*United States v. American Trucking etc.* (1940) 310 U.S. 534, 544; 60 Sup. Ct. 1059, 1064.

Koshkonong v. Burton (1882) 14 Otto 668, 678; 26 L. Ed. 886.

American School of Magnetic Healing v. McAnnulty (1902) 187 U.S. 94; 47 L. Ed. 90.

Manhattan General Equipment Co. v. Commissioner (1936) 297 U.S. 129, 134; 56 Sup. Ct. 397, 80 L. Ed. 528.

[10]*St. Joseph Stockyards Co. v. U. S.* (1936) 298 U.S. 38, 80 L. Ed. 1033;

Federal Trade Commission v. Gratz (1920) 253 U.S. 421, 64 L. Ed. 993;

Stark v. Wickard (1944) 321 U.S. 288, 64 Sup. Ct. 559;

Dismuke v. United States (1936) 297 U.S. 167; 80 L. Ed. 561.

[11]*Social Security etc. v. Nierotko* (1946) 327 U.S. 358, 369; 90 L. Ed. 718.

vision. The accepted and usual course of judicial proceeding is for courts to exercise judicial functions. The Circuit Court of Appeals departed therefrom when it declined to exercise its judicial function.

4. Any time Congress attempts to deprive a citizen of these United States of all right to go to any Court to protect himself from governmental administrative error, the free people of this country are entitled to have this Court promptly pass on the constitutionality of that attempt[12].

5. The interpretation of Section 721 of the Internal Revenue Code in reference to attributing income to prior years is an important question of federal law which has not been but should be settled by this Court[13].

6. The denial to petitioner of a right to attribute any of the life insurance proceeds to prior years is a decision of a federal question in a way probably in conflict with the applicable decisions of this Court, e.g., *Lovell v. St. Louis Mutual Life Ins. Co.* (1883) 111 U. S. 264; 28 L. Ed. 423, 4 Sup. Ct. 390, which holds that only a portion of each ordinary life insurance premium is an investment to be returned when

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[12]If certiorari is granted as a matter of course when a Circuit Court of Appeals holds an act of Congress unconstitutional (*Commissioner v. Wheeler* (1945), 324 U.S. 542, 65 Sup. Ct. 799) it should be so granted when a Court declines to exercise judicial functions because of an attempt by Congress to deprive all Courts of that power.

[13]If the cases arising from the excess profits tax laws of 1917 and 1918 are any indication 20 to 25 years of litigation are ahead unless questions are promptly clarified by this Court when raised.

the policy lapses. It fails to give effect to the intent of Congress to apply the section to all types of abnormal income.

7. Instead of interpreting Section 22(b)(2) of the Internal Revenue Code, and the words thereof in their ordinary, every day senses[14] the Circuit Court of Appeals in effect inserted in the statute the words "by the original owner." Whether such words should be inserted is a question of federal law which has not been but should be settled by this Court[15], and the Circuit Court of Appeals in so deciding has decided a federal question in a way probably in conflict with applicable decisions of this Court[16] and has so far departed from the accepted and usual course of judicial procedure[17] as to call for an exercise of this Court's power of supervision. The points here involved are of continuous importance as the statute remains unchanged since December 31, 1940.

8. The amount of life insurance contracts now outstanding from all of the life insurance companies in this country which will be affected by the interpretation of Section 22(b)(1) and Section 22(b)(2) is very

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[14]*Crane v. Commissioner* (Apr. 14, 1947), 329 U.S. ....; and footnote 13 therein.

[15]Whether the insertion of words into a federal statute affecting thousands of life insurance policies is interpretation or judicial legislation should be settled by this Court.

[16]Cf. *Iselin v. United States* (1926), 270 U. S. 245, 251, 70 L. Ed. 569;

Wallace v. Cutten (1936), 298 U.S. 229, 237, 80 L. Ed. 1157.

[17]The action of a Court in transcending the judicial function (see cases cited in footnote 16) is a wide departure from the accepted and usual course of judicial procedure.

large and the interpretation of that section should be settled by this Court. This Court has never passed on the question whether the proceeds of a life insurance policy paid on the death of the insured is income because it has not been necessary to decide that question but it has stated that such proceeds "are not usually classed as income." (*U. S. v. Supplee-Biddle, etc.* (1924), 265 U.S. 189, 44 Sup. Ct. 546.) The question is now squarely raised and should be resolved by granting certiorari and deciding the question.

9. Considering that the excess profits tax was specifically designed to recapture a portion of the profits due to the expansion and creation of activities by the war effort[18] and that the proceeds of the life insurance policies were not in any way due to such expansion or creation, to take $36,000 from such proceeds for such taxes is so grossly unjust and harsh as to make us feel that the Congress in the exercise of its good common sense never intended that such proceeds should not have the benefits extended by Section 721.

10. As this Court said in *United States v. Supplee-Biddle, etc.*, supra, life insurance proceeds are not usually classed as income. It seems probable, therefore, that the Court below erred in taking about $61,000 out of the proceeds of $141,000 for the Tax Collector, and in light of the general importance of life insurance to the contrary as a whole the rights of the Tax Collector in respect thereof should be finally settled and determined by this Court.

[18]Section 35.722.3(e) of Regulations 112.

11. This Court should be alert to compel correction of administrative error which is outside the statute and the Constitution. Such connection should be now made for future guidance of the government and the public.

12. It would seem that the gravity of the decision of the Circuit Court of Appeals in this case to the administration of the tax laws is equal to that which led this Court to grant certiorari in *Rothensies v. Electric Storage Battery Co.* (1946), 329 U. S. 296, 67 Sup. Ct. 271, and should lead this Court to grant certiorari in this case. It seems to us that the proper construction of sections 22(b)(2) and 721 of the Internal Revenue Code here involved is as important as the construction of the provisions involved in *Crane v. Commissioner* (1947), 329 U. S. ...., 67 Sup. Ct. 1047, and in *Bazley v. Commissioner* (1947), 329 U. S. ...., 67 Sup. Ct. 1489, and in *McWilliams v. Commissioner*[19] (1947), 329 U. S. ...., 67 Sup. Ct. 1477, and that this Court should grant certiorari in this case.

13. The decision of this Court in this case is of more importance to the administration of the revenue laws than was the decision in *United States v. Johnson* (1925), 268 U. S. 220, 69 L. Ed. 925.

14. Whether Section 732 violates Article III of the Constitution is a novel and important question as to which certiorari should be granted (*Louisville*

[19]A conflict between circuits also existed in this case.

Joint Stock Land Bank v. Radford (1935), 295 U. S. 555, 573, 79 L. Ed. 1593, 1595.) We are confident that that question as well as the interpretation of 721 applies to many other cases pending in which action is awaiting authoritative settlement of the questions presented herein which involve large amounts of money and will affect many, many taxpayers whose liabilities will remain unsettled until the dispute is finally settled. (*United States v. Constantine* (1935), 296 U. S. 287, 290, 80 L. Ed. 233, 236.)

CONCLUSION.

We are reluctant to add to the burdens of this Honorable Court but we strongly feel that regardless of whether petitioner is ultimately successful before this Court, this is the kind of a case that this Court should determine for the future guidance of the government, taxpayers and counsel.

We have largely omitted reference to authorities and argument in the statement for the reasons relied on for the allowance of the writ; we respectfully refer the reader to the brief filed in support of this petition.

Dated, San Francisco, California,
July 21, 1947.

Respectfully submitted,
EVERETT S. LAYMAN,
Attorney for Petitioner.

FILE COPY

In the Supreme Court
OF THE
United States

October Term, 1947

No. 224

James F. Waters, Inc. (a corporation),
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI to the United States Circuit Court of Appeals for the Ninth Circuit.

Everett S. Layman,
220 Bush Street, San Francisco 4, California,
Attorney for Petitioner.

Pernau-Walsh Printing Co., San Francisco, California

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OCTOBER TERM, 1947

No.

JAMES F. WATERS, INC. (a corporation),
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI to the United States Circuit Court of Appeals for the Ninth Circuit.

REFERENCE TO THE OFFICIAL REPORT OF THE OPINIONS DELIVERED IN THE COURTS BELOW.

This is an appeal from a decision of the United States Circuit Court of Appeals (Ninth Circuit) affirming a decision of the United States Tax Court. The opinion delivered by the Circuit Court of Appeals is found in 160 F. 2d at page 596 and following. This opinion is found in the Record at pages 286 to 293 inclusive.

The opinion of the Tax Court was not officially reported. It is found in the Record at pages 39 to 51 with the opinion proper being found at pages 49 to 51.

A CONCISE STATEMENT OF THE GROUNDS ON WHICH THE JURISDICTION OF THIS COURT IS INVOKED.

A concise statement of the grounds on which the jurisdiction of this Court is invoked is as follows:

This Court has the right to review on writ of certiorari a decision of the United States Circuit Court of Appeals.

Section 240 of the Judicial Code, as amended, 26 Stat. 828, Ch. 517, § 6, as amended, 36 Stat. 1157, Ch. 231, § 240, 43 Stat. 938, Ch. 229, § 1, Title 28, U.S.C.A. § 347, grants to this Court jurisdiction to require by certiorari, that this cause be certified to it for determination by this Court.

Judgment of the Circuit Court of Appeals of the Ninth Circuit was entered on March 19, 1947. The petition for rehearing was timely filed by petitioner on April 18, 1947 and on April 25, 1947, there was entered the order of the Circuit Court of Appeals of the Ninth Circuit denying the petition for a rehearing. (R. 293-294.)

The time for filing petition for certiorari to this Court runs from said last mentioned date.

26 Stat. 828, Ch. 517, § 6 as amended, 39 Stat. 727, Ch. 448, § 6, 43 Stat. 940, Ch. 229, § 8, Title 28, U. S.

C. A. § 350. See: *U. S. v. Ellicott,* 223 U. S. 524, 32 S. Ct. 334; *Aspen Mining & Smelting Co. v. Billings,* 150 U. S. 31, 14 S. Ct. 4; and *Commissioner of Internal Revenue v. Bedford's Estate* (1945), 325 U. S. 283, 65 S. Ct. 1157.

A CONCISE STATEMENT OF THE CASE.

A concise statement of the case is as follows:

James F. Waters, an individual, hereinafter usually called "decedent," was an automobile dealer and distributor. He incorporated James F. Waters Securities Corp., hereinafter usually called "Securities," in 1932 (R. 89) to finance the cars he sold. He incorporated petitioner in 1934 (R. 89) and it took over his operations as an automobile dealer and distributor. He was petitioner's president and chief shareholder until his death.

From 1924 to 1934 decedent procured eight life insurance policies on his life aggregating in face amount $147,000.00[a]. (R. 96.) These policies were transferred to Securities about April 26, 1935. (R. 90.) At that time decedent was paid by Securities therefor[b] $6,222.32, the cash surrender value of the policies transferred less the 1935 premiums due thereon[b]. (R. 90.) Securities paid the premiums due on all of the policies so transferred from 1935 to

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[a]Two policies the proceeds of which are not involved are omitted here and elsewhere in the interest of brevity.

[b]Two of the policies had no cash surrender value and there is a question whether they were transferred for a valuable consideration; detail is omitted here in the interest of brevity.

1938, both inclusive. On or about October 31, 1938, Securities merged with petitioner and there was then transferred to petitioner by operation of law all of said policies.

Neither petitioner nor Securities recognized any gain or loss upon said transfer. (R. 94.)

Thereafter petitioner failed to pay the premiums due on any of said policies other than on one term group policy premiums on which it continued to pay until decedent's death. (R. 93-98.)

The terms and conditions of each of said policies differ somewhat but in effect the result of the failure to pay the premiums due in 1939 caused the policies to lapse and the then cash surrender value of each of the policies was applied to the purchase of term insurance for the principal amount of the original policy for a term computed pursuant to the provisions of the respective insurance policies. At the expiration of such respective terms, the insurance became void. (R. 99-188.)

The decedent died on May 10, 1941, before the expiration of such term insurance and the petitioner received the sum of $141,693.77 as the proceeds of such term insurance. (R. 96.)

At the time of decedent's death petitioner owned the controlling interest in a Michigan corporation and a New York corporation. (R. 84.) This Michigan corporation manufactured Skyview cabs. (R. 84.) The New York corporation sold cabs manufactured by the Michigan corporation and also sold De Soto and

Plymouth automobiles in New York. (R. 84.) Petitioner then sold new and used cars at retail in San Francisco and distributed new cars at wholesale to 56 dealers in Northern California. (R. 84.)

Almost immediately following decedent's death disputes arose between petitioner and his widow. (R. 85.) In settlement of these disputes and the litigation arising therefrom petitioner paid the widow approximately $355,000 and transferred to her an improved piece of real estate. (R. 86.) Pursuant to the settlement agreement petitioner paid $57,500 to others as well as furnishing funds in excess of $100,000 to the estate[c]. (R. 86.)

Petitioner did not include any portion of the proceeds of the life insurance policies in its income in its federal income tax return for 1941, because they were exempt from taxation under IRC 22(b)(1)[d].

Respondent asserted that $106,967.56[e] of the proceeds should have been included in petitioner's gross income for 1941 and asserted deficiencies as follows[e]:

---

[c]This is exclusive of debts decedent owed petitioner and its New York subsidiary.

[d]IRC 22(b) (1) reads as follows:

"(b) *Exclusions from Gross Income.* The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(1) *Life Insurance.*—Amounts received under a life insurance contract paid by reason of the death of the insured."

[e]These are the figures resulting from respondent's amended answer rather than the original deficiency letter. The difference between the two is not material.

$21,000.71 in income taxes
3,732.42 in declared value excess profits taxes
36,197.25 in excess profits tax. (R. 36.)

Petititoner before the Tax Court and before the Circuit Court of Appeals not only claimed that under IRC Section 22(b)(1) the entire proceeds were exempt from taxation but that the proceeds were abnormal income under IRC Section 721, and as such, for purposes of the excess profits tax law, were attributable to prior years. Both the Tax Court (R. 39 et seq.) and the Circuit Court of Appeals (R. 286 et seq.) held that the life insurance proceeds were not exempt from taxation.

The Tax Court held that the life insurance proceeds were abnormal income but that no part thereof was attributable to prior years. (R. 50-51.) The Circuit Court of Appeals held (R. 290-293) that it was without jurisdiction to review the decision of the Tax Court on this phase because the Congress had provided in Section 732(c) that the determination of any question which was necessary solely by reason of Section 721 should not be reviewed by any Court or agency except the Tax Court.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals erred in the following particulars and each of them:

1. In holding that it was without jurisdiction to review the decision of the Tax Court;

2. In affirming the decision of the Tax Court holding that no portion of the life insurance proceeds was attributable to prior years;

3. In holding that the life insurance proceeds were not exempt by the provisions of Section 22(b)(1) of the Internal Revenue Code;

4. In holding that the first quoted sentence of Section 22(b)(2) applies to the facts of this case;

5. In holding that the second quoted sentence of Section 22(b)(2) does not apply to the facts of this case;

6. In failing to hold that the insurance contracts had bases for determining gain or loss in the hands of the petitioner determining in whole or in part by reference to such bases in the hands of Securities, its transferor;

7. In holding that the second quoted sentence applied only to transfers made by the original owner when the statute makes no such requirement;

8. In failing to hold that the policies transferred had lapsed and that the policies, the proceeds of which were collected, were issued in lieu of those transferred;

9. In failing to hold that the policies, the proceeds of which were collected had not been transferred to petittioner for valuable consideration or otherwise;

10. In failing to hold that the proceeds did not compensate petititoner for the loss it sustained by the loss of its President and chief shareholder;

11. In holding that the proceeds of the life insurance here involved were income under the Sixteenth Amendment.

SUMMARY OF THE ARGUMENT.

I. Congress cannot deprive petitioner of its day in Court on a question arising under I.R.C. 721 because to so do would be to violate Article III of the Constitution.

I. A. Section 721 of the Internal Revenue Code like Section 301 of the 1918 Act prescribes the elements to be considered, hence error remains subject to judicial correction.

II. The proceeds of life insurance should be excluded in computing excess profits taxes to the extent that such proceeds are attributable to prior years.

(1) The statute and the regulations require that such proceeds should be attributed to prior years.

(2) Such life insurance proceeds are attributable to prior years.

(a) Such life insurance proceeds are attributable to prior years because of the payment of premiums in prior years.

(b) Such life insurance proceeds are attributable to prior years because of

the various factors existing in prior years which were necessary conditions precedent to the existence of the term insurance on the date of death.

(c) Such life insurance proceeds are attributable to prior years because of the analogy to four of the six specific classes of abnormal income attributable to prior years particularly defined in Section 721.

(d) Such life insurance proceeds are attributable to prior years because an unfair application of the excess profits tax would result in an abnormal case if they were not so attributed.

(3) The Tax Court's reliance on, and interpretation of Section 30.721-3 of Regulations 109 is erroneous.

(a) The Tax Court erred in concluding that there are no reasons for attributing the insurance proceeds to earlier years other than the payment of premiums.

(b) The Tax Court was wrong in concluding that a premium so paid was solely an investment by the taxpayer in an intangible asset employed in or contributing to the production of such income.

(c) The regulation as interpreted by the Tax Court is invalid.

III. The proceeds of life insurance which petitioner had on the life of its president and chief shareholder should not be included in its income for Federal income taxes, declared value excess profits taxes or excess profits taxes.

A. No part of the life insurance proceeds should be included in petitioner's gross income by reason of the provisions of Section 22(b)(1) of the Internal Revenue Code, excluding from gross income amounts received under life insurance policies paid by reason of the death of the insured.

(1) The exclusion of the proceeds of the life insurance policies from gross income is not limited by Section 22(b)(2) of the Internal Revenue Code.

(2) Section 22(b)(2) has no application because the policies transferred had lapsed, and the policies the proceeds of which were collected were issued in lieu of those transferred.

(a) As a matter of fact they were different contracts.

(b) As a matter of law the policies transferred were not the policies collected on.

B. The proceeds of life insurance do not compensate petitioner for the loss it sustained upon

the death of its president and chief shareholder.

C. The proceeds of the life insurance are not income under the Sixteenth Amendment.

Three questions were presented in the petition for review on writ of certiorari. They will be presented in this brief in the same order.

I. CONGRESS CANNOT DEPRIVE PETITIONER OF ITS DAY IN COURT ON A QUESTION ARISING UNDER SECTION 721 OF THE INTERNAL REVENUE CODE BECAUSE TO DO SO WOULD BE TO VIOLATE ARTICLE III OF THE CONSTITUTION.

The Tax Court in this case determined that the life insurance proceeds were abnormal income but that they were "not attributable to prior years." (R. pp. 50-51.) Such determination was necessary solely by reason of the interpretation of Section 721 of the Internal Revenue Code and the regulations issued thereunder.

Section 732 of that code provides that such determination "shall not be reviewed or redetermined by any court or agency except the" Tax Court.

Article III of the Constitution vests the judicial power of the United States in the Supreme Court and in such inferior Courts as the Congress may from time to time establish.[1] The judicial power extends

[1] "The Judicial Power of the United States shall be vested in one Supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.* * *"

to all cases in law and equity, arising under the laws of the United States.[2]

The Tax Court while called a court is not a court but is an executive administrative agency.[3]

The question whether any portion of the life insurance proceeds is attributable to previous years is one of law.

Whether any is so attributable requires an interpretation of Section 721 of the Internal Revenue Code and of Section 35.721-3 of Regulations 109, and requires a determination of the validity of one sentence of the Regulations as interpreted by an executive administrative agency; i.e., the Tax Court.

Such interpretations and such determination of validity require an exercise of the judicial power of the United States. Congress cannot deprive the

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[2] "The Judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority; * * *"

(Article III, Section 2, Constitution of the United States.)

[3] Section 1100 of the Internal Revenue Code says:

"The Board of Tax Appeals (hereinafter referred to as the 'Board') shall be continued as an independent agency in the Executive Branch of the Government. The Board shall be known as The Tax Court of the United States and the members thereof shall be known as the presiding judge and the judges of The Tax Court of the United States."

Also see

Old Colony etc. v. Commissioner (1929), 279 U.S. 716, 49 Sup. Ct. 499;

Goldsmith v. United States etc. (1926), 270 U.S. 117, 46 Sup. Ct. 215;

Helvering v. Rankin (1935), 295 U.S. 123, 55 Sup. Ct. 732;

Commissioner v. Gooch etc. (1943), 320 U.S. 418, 64 Sup. Ct. 184.

Courts of that power; Congress cannot vest that power in the Executive Branch of the Federal Government.

The general rule inherent in the American constitutional system is that legislature cannot exercise either executive or judicial power; the executive cannot exercise either legislative or judicial power; the judiciary cannot exercise either executive or legislative power.[4]

The interpretation of the meaning of statutes, as applied to justiciable controversies is exclusively a judicial function.[5]

> *State of Tennessee v. Davis* (1879), 100 U.S. 257, 25 L. Ed. 648 at 650:
>
> "A case consists of the right of one party as well as the other, and may truly be said to arise under the Constitution or a law or a treaty of the United States whenever its correct decision depends upon the construction of either."

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[4]*Springer v. The Philippine Islands* (1928), 277 U.S. 189, 72 L. Ed. 845.

[5]*United States v. American Trucking etc.* (1940), 310 U.S. 534, 544, 60 Sup. Ct. 1059, 1064.

Also see:

Hamilton in the Federalist, No. LXXVIII;
Marbury v. Madison (1803) 1 Cranch. 137, 2 L. Ed. 60;
Martin v. Hunter's Lessee (1816), 1 Wheat. p. 304, 4 L. Ed. 97;
Ableman v. Booth (1859), 21 How. 506, 16 L. Ed. 169;
American etc. v. McAnnulty (1902), 187 U.S. 94, 47 L. Ed. 90;
Manhattan etc. v. Commissioner (1936), 297 U.S. 129, 134, 56 C. Ct. 397, 80 L. Ed. 528;
Koshkonong v. Burton (1882), 14 Otto 668, 678, 26 L. Ed. 886.

United States v. Dickson (1841), 15 Peters 141, 10 L. Ed. 689 at 697:

"But it is not to be forgotten that ours is a government of laws and not of men, and that the judicial department has imposed upon it by the Constitution the solemn duty to interpret the laws, in the last resort; and however disagreeable that duty may be, in cases where its own judgment shall differ from that of other high functionaries, it is not at liberty to surrender, or to waive it."

The judicial power of a competent court cannot be circumscribed by any legislative arrangement designed to give effect to administrative action beyond the limits of constitutional authority.[6]

Congress cannot sap the judicial power as it exists under the Federal Constitution and establish a government of bureaucratic character alien to our system.[7]

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[6] *St. Joseph Stockyards Co. v. United States* (1936), 298 U.S. 38, 80 L. Ed. 1033.

Also see:

Federal Trade Commission v. Gratz (1920), 253 U.S. 421, 64 L. Ed. 993;

Dismuke v. United States (1936), 297 U.S. 167, 80 L. Ed. 561;

Stark v. Wickard (1944), 321 U.S. 288, 64 Sup. Ct. 559.

Also see:

Social Security Board v. Nierotko (1946), 327 U.S. 358, at p. 369, 90 L. Ed. 718: "An agency may not finally decide the limits of its statutory power. That is a judicial function."

[7] *Crowell v. Benson* (1932), 285 U.S. 22, 76 L. Ed. 598. (We here parenthetically add the complaint of the colonists against the British Crown in the Declaration of Independence in depriving them of jury trials in cases involving Crown revenues where they "submitted to a candid world" as facts that the king had

Under Sections 327 and 328 of the Revenue Act of 1918 discretionary powers were vested in the Commissioner, and this Court held that the exercise of these discretionary powers was final and not subject to reviewing by the courts in the absence of fraud or other irregularities.

> *Williamsport etc. v. United States* (1928), 277 U.S. 551, 48 Sup. Ct. 587;
>
> *Welch v. Obispo Oil Co.* (1937) 301 U.S. 190, 57 Sup. Ct. 684;
>
> *Heiner v. Diamond Alkali* (1933) 288 U.S. 502, 53 Sup. Ct. 413.

This Court in the *Heiner* case pointed out in unmistakable language the distinction between Sections 328 and 301 of the 1918 Act in that Section 301 prescribed the elements to be considered and therefore error remained subject to judicial correction while the discretionary powers under Sections 327 and 328 were not subject to judicial control. In reaching this result, the following is the language of this Court on this subject:

> "The respondent's tax could only be computed in accordance with Section 301 or under Section 328. The former prescribes the elements to be considered, and error in the computation remains subject to judicial correction; the latter grants the taxpayer the benefit of discretionary action by the Commissioner, and precludes judicial re-

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"combined, with others, to subject us to a jurisdiction foreign to our constitution * * * for imposing taxes on us without our consent" and "for depriving us in many cases of the benefit of trial by jury.")

vision or alteration of the computation of the tax."

It is thus apparent that the *Williamsport* case passed on the finality of discretionary powers under certain circumstances; it plainly states that where the statute prescribes the elements to be considered error remains subject to judicial correction.

I-A. SECTION 721 OF THE INTERNAL REVENUE CODE LIKE SECTION 301 OF THE 1918 ACT PRESCRIBES THE ELEMENTS TO BE CONSIDERED, HENCE ERROR REMAINS SUBJECT TO JUDICIAL CORRECTION.

Section 301 of the Revenue Act of 1918 (quoted in full in the appendix hereto at pages xix to xxi (and which in the *Diamond Alkali* case is contrasted with Section 328) provides for a higher rate of tax on the net income of a corporation which is derived from any government contract made between April 6, 1917 and November 11, 1918. This was a war-profits and excess profits tax. The tax was to be computed at the higher rate in the same ratio as "the part of the net income *attributable* to such Government contract * * * bears to the entire net income" and the portion taxed at the lower rate was to be on the same ratio "as the part of the net income *not attributable* to such Government contract * * * bears to the entire net income. * * * For the purpose of determining the part of the net income *attributable* to such Government contract or contracts, the proper apportionment and allocation of the deductions with respect to gross income derived from such Govern-

ment contract or contracts and from other sources, respectively, shall be determined under rules and regulations prescribed by the Commissioner with approval of the Secretary."

This is the section that this Court in the ***Diamond Alkali*** case says "prescribes the elements to be considered, and error in the computation remains subject to judicial correction."

Note the striking similarity of Section 721 of the Internal Revenue Code (quoted in full in the appendix hereto at pages iii to ix to the language found in Section 301 of the 1918 Act. It too "prescribes the elements to be considered." It does not grant "the taxpayer the benefit of discretionary action by the Commissioner." Error, as this Court said, remains subject to judicial correction.

We quote from Section 721:

"SEC. 721. ABNORMALITIES IN TAXABLE PERIOD.

(a) DEFINITIONS.—For the purpose of this section—

(1) ABNORMAL INCOME.—The term 'abnormal income' means income of any class includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous

taxable years, the taxable years during which the taxpayer was in existence."

* * * * * * *

"(3) Net abnormal income—the term 'net abnormal income' means the amount of the abnormal income less, under regulations prescribed by the Commissioner with the approval of the Secretary, (a) 125 per centum of the average amount of the gross income of the same class determined under paragraph (1), and (B) an amount which bears the same ratio to the amount of any direct costs or expenses, deductible in determining the normal-tax net income of the taxable year, through the expenditure of which such abnormal income was in whole or in part derived as the excess of the amount of such abnormal income over 125 per centum of such average amount bears to the amount of such abnormal income.

(b) Amount attributable to other years—The amount of the net abnormal income that is attributable to any previous or future taxable year or years shall be determined under regulations prescribed by the Commissioner with the approval of the Secretary. In the case of amounts otherwise attributable to future taxable years, if the taxpayer either transfers substantially all its properties or distributes any property in complete liquidation, then there shall be attributable to the first taxable year in which such transfer or distribution occurs (or if such year is previous to the taxable year in which the abnormal income is includible in gross income, to such latter taxable year) all amounts so attributable to future taxable years not included in the gross income of a previous taxable year.

(c) COMPUTATION OF TAX FOR CURRENT TAXABLE YEAR—The tax under this subchapter for the taxable year, in which the whole of such abnormal income would without regard to this section be includible, shall not exceed the sum of:

(1) The tax under this subchapter for such taxable year computed without the inclusion in gross income of the portion of the net abnormal income which is attributable to any other taxable year, and

(2) The aggregate of the increase in the tax under this subchapter for the taxable year (computed under paragraph (1) and for each previous taxable year which would have resulted if, for each previous taxable year to which any portion of such net abnormal income is attributable, an amount equal to such portion had been included in the gross income for such previous taxable year."

There is no hint of discretionary power in this section. Section 721 of the Internal Revenue Code is before this Court in this case and that section, like Section 301 of the Revenue Act of 1918, prescribes the elements to be considered and, in the language of this Court in *Heiner v. Diamond Alkali Company*, supra, error remains subject to judicial correction.

We submit that Congress cannot deprive a taxpayer of his day in a court on any question arising under Section 721.[8]

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[8]We believe it is not necessary to argue the question of whether the Circuit Court of Appeals is exercising a judicial function when it reviews a decision of the Tax Court. See *Old Colony etc. v. Commissioner* (1929), 279 U.S. 716, 49 Sup. Ct. 499.

Having shown our right to a court review, which was denied to us by the court below on the question of excess profits taxes, we now present that question on its merits.

II. THE PROCEEDS OF LIFE INSURANCE SHOULD BE EXCLUDED IN COMPUTING EXCESS PROFITS TAXES TO THE EXTENT THAT SUCH PROCEEDS ARE ATTRIBUTABLE TO PRIOR YEARS.

The Tax Court held that the life insurance proceeds were abnormal income. (R. 50.) Hence on the merits the question is to what extent they are attributable to years other than the year of death and collection.

The excess profits tax was specifically designed to recapture a portion of the profits due to the expansion and creation of activities by the war effort.[9]

The proceeds of the life insurance policies were not in any way due to the expansion and creation of activities by the war effort. It seems extraordinary that it would be thought that life insurance, which is normally not considered as income at all, should bear the added burden of this tax, when it plainly does not fall within the classification of the profits it was specifically designed to recapture.[10]

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[9]Section 35.722-3(e) of Regulations 112.

[10]The Ways and Means Committee Report in the 1941 bill makes it plain that Section 721 was intended to apply to all items of abnormal income. In that Report (1941-1 C.B., pp. 550, 551 and 556) it is in part said:

> "This Act had two major purposes, as was stated in the report of your committee. These purposes were, first, to provide additional revenue urgently needed to help meet the costs of the national defense program, and, second, to prevent

It is plain that Congress intended that Section 721 should apply to every type of abnormal income. That means that Congress intended that it should apply to this case.

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(1) THE STATUTE AND THE REGULATIONS REQUIRE THAT SUCH PROCEEDS SHOULD BE ATTRIBUTED TO PRIOR YEARS.

The statute with the use of the mandatory "shall" requires that the tax "shall not exceed * * * the tax under this subchapter of such taxable year computed *without the inclusion in gross income* of the portion of the net abnormal income which is *attributable* to any other taxable year * * *"

The Commissioner's regulations (Regulations 109, Section 35.721-3) in part provides that:

> "Items of net abnormal income are to be attributed to other years in the light of the events in which such items had their origin, and only in

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the rearmament program from *furnishing an opportunity for the creation of new war millionaires* or the further substantial enrichment of already wealthy persons.

"In view of these compelling motives, the provisions of that Act lay a tax upon that portion of the earnings of corporations determined to be excess profits. The tax rates provided, or even higher rates, are thoroughly justified *if the income subject thereto is clearly of the type intended to be reached.* At the same time, *equitable considerations demand that every reasonable precaution be taken to prevent unfair application of the tax in abnormal cases. The weight of the burden imposed carries with it a commensurate need for restricting its application to the cases for which it was designed*

* * * * * * *

"*It is believed advisable to extend the principle of this section to any abnormal item of income.* As the types of abnormal income that may occur can not be predicted in advance, adequate relief can only be granted by thus extending the scope of this section."

such amounts as are reasonable in the light of such events * * *"

It is incontrovertible that where the policies are issued and where the premiums are all paid in a year prior to the death of the insured, that these items i.e, the insurance proceeds, certainly had their origin in the years in which the policies were issued and the premiums were paid, not in the year of death. That year is the year of maturity,[11] not of origin.

Term insurance differs from ordinary life insurance. In ordinary life insurance, if the period for which the premium is paid expires, there is a residual value, namely, the cash surrender value. In term insurance, when the period expires for which the premium has been paid, there is nothing left. It must be true, therefore, that the insurance proceeds "had their origin" in the taking out of the policy, the paying of the premiums and the conversion into insurance in the nature of term insurance in 1939. The policies matured upon the death of the insured in 1941; they did not have their origin then.

Webster defines the word "attribute" in part as follows: "to ascribe by way of cause * * * as, a disease attributed to filth; to attribute power to a charm * * *" Webster defines "ascribe as "to * * * assign as a cause or source * * *"

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[11]2 *Bacon on Life & Accident Insurance*, 4th Ed., page 1357 says:

"With life insurance companies * * * death * * * is generally the event which is to * * * mature the liability."

Part of the proceeds of the policies must be ascribed by way of cause to (1) the taking out of the policy (otherwise the proceeds would never have been collected); (2) the state of the decedent's health (for had he been in bad health there would never have been a policy); and (3) the payment of premiums (for these premiums had to be paid in order to keep the insurance alive). Hence in the natural, ordinary and familiar meaning[12] of the word *attributable,* the proceeds of the policies are attributable to years other than the year in which decedent's death occurred particularly where the policies had been in force during a substantial number of years.

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(2) SUCH LIFE INSURANCE PROCEEDS ARE ATTRIBUTABLE TO PRIOR YEARS.

In light of the purpose of the law to recapture war profits, the purpose to have the benefits of Section 721 reach every item of abnormal income, the intelligent and sympathetic administration thereof which the Congress desired, there should be no difficulty in attributing to prior years the whole or much of the life insurance proceeds here involved.

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[12]See 1 *Merten's Law of Federal Income Taxation,* Section 3.14, p. 77.

Also see

Crane v. Commissioner (April 14, 1947), 329 U.S.........., and footnote 13.

(a) Such life insurance proceeds are attributable to prior years because of the payment of premiums in prior years.

Premiums must be paid to keep the insurance in force. So part of the cause of the insurance proceeds being collected in the year of death is the premiums paid in earlier years. The insurance proceeds are then attributable in part to each premium paid. Therefore the proceeds of each policy are attributable to the years in which the premiums on such policy were paid.

This is convincingly illustrated by a detailed consideration of the date of issue and premiums paid on the Travelers Insurance policy for $10,000 which is Exhibit 9. (R. 176-188.) A tabulation showing the date and amount of each premium payment and the cash surrender value at such dates, is as follows:

Date	Amount of Premium Paid	Cash Surrender Value
March 6, 1933	$271.80	None
March 6, 1934	271.80	None
March 6, 1935	271.80	None
March 6, 1936	271.80	$363.10
March 6, 1937	271.80	522.20
March 6, 1938	271.80	701.30
March 6, 1939	None	863.30
Totals	$1,630.80	

(R. 176-188.)

At the time this policy was transferred in April, 1935, it had no cash surrender value (Exhibit 9; R. 176-188); and no sum was included in the payment made by reason of, or for, this policy. Petitioner thereafter paid premiums aggregating $815.40. (R.

194.) The proceeds must be attributed in part to those payments. It follows that the proceeds should be attributed in part to those years (and we think likewise to the years in which the premiums were paid by the insured before the transfer in 1935).

If Securities had not paid the premium due on March 6, 1936 (the first year after the policy was transferred), the insurance would have continued from March 6, 1936, as term insurance for three years and 235 days, i.e., until October 27, 1939. (R. 188.) The insurance under that policy would have then terminated. The decedent did not die until May 10, 1941. Hence, if the premium due March 6, 1936, had not been paid, no insurance proceeds would have been collected from this policy on the decedent's death. The proceeds must be attributed in part to the premium paid March 6, 1936.

That policy was taken out by the decedent about March 6, 1933, and he paid the premiums until its transfer. If that had not been done, but the policy had been taken out on March 6, 1934, by the decedent and thereafter transferred to petitioner and petitioner had paid the premiums in 1935 and 1936 but not thereafter, we again would have the term insurance expiring October 27, 1940, about six months before his death. Hence the fact that the policy was taken out before 1936 and premiums paid thereon, is vital. The premiums prior to the transfer, in part, caused the insurance proceeds to be collectible.

The collection of the proceeds of this Travelers policy was certainly caused in part by the fact that

the policy was not first taken out in 1936, but that it had been taken out by decedent prior to transfer and premiums paid by decedent prior to transfer. The proceeds, therefore, are attributable to the years in which those events took place. To decline to recognize this simple truth is to ignore fact and to substitute fictions therefor which neither conform to the truth nor to the desires of Congress nor to a fair and equitable distribution of the excess profits tax burden.

This, of course, similarly applies to all the premiums paid on all the policies both by decedent and by petitioner. If the premiums had not been paid there would have been no proceeds. The proceeds, therefore, are attributable in part to the payment of premiums and to the years in which the premiums were paid.

(b) Such life insurance proceeds are attributable to prior years because of the various factors existing in prior years which were necessary conditions precedent to the existence of the term insurance of the date of death.

The insurance proceeds are attributable to the events which occurred or the facts which obtained in the years prior to 1940 and 1941. In addition to the payment of the premiums during such earlier years, there are several facts which require some portion, if not all, of the proceeds to be attributable to such years.

(1) The fact that the respective policies were taken out by decedent at the times when they were so taken out determined the length of the period of

coverage of each term policy issued in lieu of the respective life policies when petitioner deliberately defaulted in the payment of the premiums due in 1939. If the decedent had taken the policies out at a later date, the term in each instance would have been shorter and might have expired prior to decedent's death, in which event petitioner would have received no insurance proceeds. The fact, therefore, that the policies were taken out on their respective dates of issuance is a fact which causes some portion, if not all, of the proceeds to be attributable to earlier years. Nothing was done in 1940 or 1941 which had anything to do with the determination of the length of the period of coverage.

(2) The fact that the decedent was in such a condition of health as to permit the issuance of such policies from 1924 when the first policy was taken out until 1933 when the last policy was taken out, is a fact by reason of which some portion, if not all, of the proceeds of the policies should be attributable to such earlier years. The decedent's health, good or bad, during the year 1939, when the insurance was converted into term insurance by reason of the failure to pay the premiums then due and thereafter until the time of his death, had nothing to do with the receipt of the proceeds of the policy. The only event which occurred subsequent to 1939 with respect to these policies was the decedent's death in 1941 and the collection of the proceeds. His health at the time the policies were issued determined whether or not they should be so issued and could be converted, and

for that reason some portion, if not all, of the proceeds should be attributable to years prior to 1941.

(3) The fact that the decedent, rather than petitioner took out the insurance policies certainly is a fact which occurred in the years prior to 1940. All of the policies were taken out before petitioner's incorporation. (The group policy was in effect the renewal of an earlier group policy taken out by the decedent.) The transfers of the policies to petitioner's predecessor were in 1935. This was an event in which the petitioner's interest in the policy had an origin. If they had not been transferred petitioner would not have gotten the proceeds. If petitioner itself had taken the policies out on decedent's life, which it could have done after its incorporation if the insured's health permitted, none of the proceeds of the insurance policies would have been income. (Internal Revenue Code, Section 22(b)(1) and (2).)

(4) In October of 1938 James F. Waters Securities Corp. was merged with petitioner and the insurance policies were transferred to petitioner by operation of law. That was an additional fact which requires the proceeds to be attributable to years prior to 1941. It, too, was an event in which the policies and their proceeds had an origin.

(5) No premiums were paid on any of the insurance policies, except the group insurance policy, during the years 1939, 1940 or 1941. (R. 93-98.) Nothing was done in those years and no events occurred therein except the death of the decedent and the collection of the proceeds and for that reason

a portion, if not all, of the insurance proceeds are attributable to years prior thereto.

The foregoing including the payment of premiums are in the language of the regulation (Reg. 109, Sec. 35.721-3) "the events in which" the insurance proceeds "had their origin." The proceeds should "be attributed to" those "years in the light of" those events.

It seems unreasonable, harsh and unjust to tax this abnormal income, i.e., the insurance proceeds, by virtue of a statute designed to recapture profits due to conditions occasioned by war when the facts which gave rise to the proceeds had their origin as early as 1924 (R. 89) and no event occurred subsequent to 1939, other than the death of the decedent, the collection of the proceeds, and the payment of premiums on the one group policy. The insurance proceeds were attributable to many things other than the death and collection of proceeds. Hence some portion, if not all, of such proceeds are attributable to years other than 1941.

They are likewise so attributable by reason of their analogy to certain of the specific clauses described in Section 721.

(c) Such life insurance proceeds are attributable to prior years because of the analogy to four of the six specific classes of abnormal income attributable to prior years particularly defined in Section 721.

Section 721(a)(2) of the Internal Revenue Code specifies six types of abnormal income, several of which are sufficiently analogous to the receipt of in-

surance proceeds to demonstrate that the abnormal income realized by the receipt of such proceeds should receive the same treatment as those six specified categories of income.

Section 721(a)(2)(A) describes "income arising out of a claim, award, judgment or decree" as a separate class of abnormal income.

Section 721(a)(2)(B) refers to "income constituting an amount payable under a contract the performance of which required more than twelve (12) months" as a separate type of abnormal income.

Section 721(a)(2)(C) defines as a separate class of abnormal income "income resulting from exploration, discovery, prospecting, research or development of tangible property, patents, formulæ or processes."

A fourth separate class of abnormal income described in Section 721(a)(2)(E) is income included in the taxable year of a lessor of real property by reason of the termination of a lease.

Bearing in mind that Congress intended that the provisions of Section 721 should apply to every type of abnormal income (supra, pp. 20, 21) there is no logical basis for distinction between attributing these four types of abnormal income and attributing the proceeds of life insurance over the life of the insurance policy.

If one may attribute income realized upon the termination of a lease to prior years and spread such income over the term of the lease, petitioner should likewise be able to spread insurance proceeds over the

length of time the policies have been in force. Thus, for example, the earliest dated policy here in question is The Prudential Life Insurance Company Policy #4798920, which was taken out July 29, 1924. (R. 89.) Its proceeds, $5,500.00, were realized May 10, 1941, sixteen years and 285 days later. Following the analogy in attributing and spreading income realized by the termination of a lease, it is proper to attribute to each of the years 1924 to 1941 the amount of income attributable thereto on a pro rata basis; thus with respect to that policy there would be attributed to 1940 and included in excess profits tax income $327.73 and to 1941 $116.73. The remaining $5,055.54 is attributable to the 14 years and 235 days prior to December 31, 1939, during which the policy was in force.

Following the same illustration with respect to the Travelers Insurance Company Policy #1749830 (R. 157-171) which was taken out March 6, 1933 (R. 91) and which matured May 10, 1941, eight years and 65 days later, $1,222.75 of the $10,000 proceeds is attributable to 1940 and $435.50 to 1941 for the purpose of computing excess profits tax net income; the balance is attributable to the years 1933 to 1939.

The foregoing illustrates a reasonable method (which finds close analogy in the regulations) of allocating to earlier years proceeds of life insurance attributable thereto. An alternative basis is to attribute the proceeds to the years in which the premiums were paid. By this method all of the proceeds would be allocated to taxable years prior to 1940. Either method appears reasonable.

It is clear from the foregoing analysis of subsections (A), (B), (C) and (E) of Section 721(a)(2) that the purpose of Section 721 is to exonerate from the excess profits tax, income which is perhaps fortuitously received in the taxable year rather than some earlier year, or which is the result of events in earlier years in which the income had its origin. Certainly insurance is within this class of income. The proceeds are the result of the facts that the insured procured the insurance in earlier years, paid the premiums thereon in earlier years, and assigned the policies to petitioner which paid premiums thereon for several years. Were it not for all of these facts, which occurred prior to 1941, the insurance proceeds would not have been received. Hence the proceeds of the life insurance had their origin in those facts, and are attributable thereto.

(d) Such life insurance proceeds are attributable to prior years because an unfair application of the excess profits tax would result in an abnormal case if they were not so attributed.

Equitable considerations demand that every reasonable precaution be taken to prevent unfair application of the excess profits tax in abnormal cases.[13] The purpose of the law was to tax excess profits arising from the war. If the respondent's position is correct, petitioner would pay $36,197.25 as excess profits tax on the proceeds of life insurance aggregating $141,-699.77, and after paying normal taxes and the cost of the policies, would net $46,937.18; thus the federal

[13] Ways and Means Committee Report on the 1941 Revenue Act (1941 C.B. p. 550).

government would receive in taxes over $60,000 (of which $36,000 would be excess profits taxes), the cost of the policies would be over $34,000 and the petitioner's net $46,000. When these policies owed their very existence to the fact that they had been carried over a long number of years and that no premiums had been paid on them after 1938, it is unfair to tax those proceeds and at the same time exclude the specific types of abnormal income, particularly those described in subdivisions (A), (B), (C) and (E) of Section 721(a)(2). Petitioner had abnormal income. It is unfair to tax all of that income at the higher rates.

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(3) THE TAX COURT'S RELIANCE ON, AND INTERPRETATION OF SECTION 30.721-3 OF REGULATIONS 109 IS ERRONEOUS.

The Tax Court in holding that no portion of the insurance proceeds were attributable to prior years relied on a sentence of the Regulations[14] reading as follows:

> "No portion of an item of net abnormal income is to be attributed to any previous year solely by reason of an investment by the taxpayer in assets tangible or intangible employed in or contributing to the production of such income";

In reaching its conclusion the Tax Court apparently holds three things:

First, that the payment of insurance premiums was the sole reason for attributing the insurance proceeds to earlier years;

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[14]Regulations 109, Sec. 30.721-3.

Second, that such premiums were solely "an investment by the taxpayer" in intangible assets "contributing to the production of such income;" and

Third, that the regulation so interpreted was valid.

The Tax Court was plainly wrong in each of the positions so taken.

(a) The Tax Court erred in concluding that there are no reasons for attributing the insurance proceeds to earlier years other than the payment of premiums.

The Tax Court erred in holding that the payment of the insurance premiums was the sole reason for attributing the insurance proceeds to earlier years for there are reasons for attributing the insurance proceeds to earlier years in addition to the payment of premiums. This has been presented above at pages 26 to 33.

(b) The Tax Court was wrong in concluding that a premium so paid was solely an investment by the taxpayer in an intangible asset employed in or contributing to the production of such income.

The payment of a premium upon an ordinary life insurance policy may be considered as an investment to the extent that such premium payment augments the cash surrender value of the policy, but the portion of each premium which is paid as a consideration for the risk assumed by the insurance company of the death of the insured during the ensuing premium period is not an investment.

With respect to term insurance all the premiums paid are in consideration of the insurance company's assumption of a liability in a specified amount in the

event that the insured should die during the term of the policy, and none of the consideration given for term life insurance is an investment; it is the consideration paid for the risk assumed. There is no investment increasing cash surrender value.

During the years prior to 1939 decedent and Securities paid periodic premiums on the policies (other than the group policy which was always term insurance), which payments accomplished two results:

(1) A protection was afforded the beneficiary against the loss occasioned by decedent's death during the premium period; this payment for this protection was not an investment;

(2) A reserve fund was accumulated which created a cash surrender value; to the extent of the portion of the premium so applied such portion might be likened to an investment.

The statements are amply supported by decisions.

Lovell v. St. Louis Mutual Life Insurance Company (1883), 111 U.S. 264, 28 L. Ed. 423, 4 Sup. Ct. 390;

Century Wood Preserving Co. v. Commissioner (C.C.A. 3rd 1934), 69 F. (2d) 967;

E. A. Armstrong (1925), 1 B.T.A. 296;

Standard Brewing Company (1927), 6 B.T.A. 980;

Keystone Consolidated Publishing Company (1932), 26 B.T.A. 1210;

London Shoe Company Inc. v. Commissioner (C.C.A. 2nd 1935), 80 F. (2d) 230, Cert. den. 298 U.S. 663.

Thus, *ordinary* life insurance is a combination of (1) insurance protection against the loss to the beneficiary occasioned by the death of the insured, and (2) an investment. The payment for such protection is not an investment.

We have thus seen that under a reasonable interpretation of the regulation we do not seek to attribute the proceeds of the life insurance company to years prior to 1940 *solely* by reason of an investment. Moreover, the insurance here involved was term insurance after 1939 and had entirely lost any investment characteristic.

Thus properly interpreted the Commissioner's regulation does attribute the whole or part of the insurance proceeds here involved to earlier years.

If the regulation forbids attributing life insurance proceeds to earlier years it is inconsistent with the statute and hence void.

(c) The regulation as interpreted by the Tax Court is invalid.

In Section 721 it is provided that "the amount of the net abnormal income that is attributable to any previous * * * taxable year or years shall be determined under regulations prescribed by the Commissioner with the approval of the Secretary, * * *" Such regulations, however, can not be inconsistent with the statute.

If proceeds of life insurance are reasonably attributable to years other than the year of death and collection, even with this authority the Commissioner can not override the authorization of the

statute and make a regulation contrary to the express intention of Congress that the law was to apply to every item of abnormal income.

To the extent that regulations are inconsistent with the statute they are void and not effective.

See *Helvering v. Janney* (1940), 311 U. S. 189, 61 Sup. Ct. 241; *Taft v. Helvering* (1940), 311 U. S. 195. 61 Sup. Ct. 244.

As interpreted by the Tax Court in the Premier Products case (2 T.C. 445) the regulation[15] says that no portion of life insurance proceeds which are abnormal income is to be attributed to any previous year. The statute was to apply to all types of abnormal income. The regulation as interpreted excludes life insurance. It is therefore inconsistent with the statute and void.

We have thus shown that the Tax Court's decision in the *Premier Products* case was wrong.

In the foregoing we have asked for a fair application of a law designed to recapture excess war profits. In so doing we have assumed that the life insurance proceeds were taxable income. We now present our next major point, namely, that the proceeds were not taxable income.

[15]"No portion of an item of net abnormal income is to be attributed to any previous year solely by reason of an investment by the taxpayer in assets, tangible or intangible, employed in or contributing to the production of such income."

III. THE PROCEEDS OF LIFE INSURANCE WHICH PETITIONER HAD ON THE LIFE OF ITS PRESIDENT AND CHIEF SHAREHOLDER SHOULD NOT BE INCLUDED IN ITS INCOME FOR FEDERAL TAXES, DECLARED VALUE EXCESS PROFITS TAXES OR EXCESS PROFITS TAXES.

A. NO PART OF THE LIFE INSURANCE PROCEEDS SHOULD BE INCLUDED IN PETITIONER'S GROSS INCOME BY REASON OF THE PROVISIONS OF SECTION 22(b)(1) OF THE INTERNAL REVENUE CODE, EXCLUDING FROM GROSS INCOME AMOUNTS RECEIVED UNDER LIFE INSURANCE POLICIES PAID BY REASON OF THE DEATH OF THE INSURED.

Petitioner and respondent are in agreement that if Section 22(b)(1)[16] does apply the proceeds shall not be included in gross income and shall be exempt from taxation.

(1) The exclusion of the proceeds of the life insurance policies from gross income is not limited by Section 22(b)(2) of the Internal Revenue Code.

There are two sentences of Section 22(b)(2) which affect Section 22(b)(1). The first of these sentences reads as follows:

> "In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph."[17]

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[16] "Amounts received under a life insurance contract paid by reason of the death of the insured * * * shall be exempt from taxation under this chapter." Internal Revenue Code, Sec. 22(b)(1).

[17] This sentence is referred to in this brief as "the first quoted sentence."

The second sentence immediately follows the first and reads as follows:

> "The preceding sentence shall not apply in the case of such a transfer if such contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor."[18]

Petitioner and respondent are in agreement that if the first quoted sentence is applicable to the facts of this case, then the proceeds are includible and should be taxed.

Petitioner and respondent are also in agreement that if the second quoted sentence is applicable then no portion of the proceeds should be included in taxpayer's income and all thereof is exempt from taxation.

Petitioner and respondent, however, are in disagreement as to which of the two quoted sentences is applicable.

It is plain that if the second sentence is applicable, the first is not.

The second quoted sentence provides that the first quoted sentence "shall not apply in the case of * * * a transfer" for a valuable consideration "if such contract * * * has a basis for determining gain or loss in the hands of a transferee determined in whole or

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[18]This sentence is referred to in this brief as "the second quoted sentence."

in part by reference to such basis of such contract * * * in the hands of the transferor."

The insurance contracts which were transferred to petitioner in 1938 were transferred when Securities was merged into petitioner. (R. 94.) That transfer was unquestionably a transfer for a valuable consideration.[19] The basis of the property acquired upon the merger is the same as it was in the hands of Securities as Internal Revenue Code Section 113(a)(7), provides that "if the property was acquired * * * (B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization[20] then the basis shall be the same as it would be in the hands of the transferor."

It is, therefore, apparent that the first quoted sentence does not apply to these transfers to petitioner, which transfers were for a valuable consideration, because the contracts so transferred had a basis for determining gain or loss in the hands of petitioner (i.e., the transferee) determined in whole or in part by reference to such basis in the hands of Securities (i.e., the transferor).

The Statute is plain and unambiguous and leaves no room for interpretation.

The Circuit Court of Appeals says that the limitation of the second quoted sentence was "to be effective only if the transfer by the *original owner* of the policy

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[19] *King Plow Company* (C.C.A. 5th, 1940), 110 F. (2d) 649.

[20] A statutory merger is a reorganization, Internal Revenue Code, Section 112(g).

was one in which the transferee took the transferor's basis." That is judicial legislation; because what the Court said is not what the statute said. The Court inserts into the statute the words "by the original owner." Inserting words is not interpreting, it is judicial legislation. Petitioner does not stand "in the shoes of its transferor" because the second quoted sentence exonerated it from the burdens put on its transferor by the first quoted sentence.

As was said by this Court in ***Iselin v. United States*** (1926), 270 U.S. 245, 251, 70 L. Ed. 569:

> "What the government asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included within its scope. To supply omissions transcends the judicial function. Compare United States v. Weitzel, 246 U.S. 533, 543, 62 L. ed. 872, 874, 38 Sup. Ct. Rep. 381; Peoria & P. U. R. Co. v. United States, 263 U.S. 528, 534, 535, 68 L. ed. 427, 430, 431, 44 Sup. Ct. Rep. 194."

Also see ***Wallace v. Cutten*** (1936), 298 U.S. 229, 237, 80 L. Ed. 1157.

Here as in the last cited case, on the face of the statute there can be no doubt concerning the intention of Congress. What the Circuit Court did was not to construe the statute but to enlarge it, to supply a possible omission. To supply omissions transcends the judicial function.

(2) Section 22(b) (2) has no application because the policies transferred had lapsed, and the policies the proceeds of which were collected were issued in lieu of those transferred.

Looking at the substance of the transaction, petitioner took the cash surrender value of the policies which were transferred and with such cash surrender value bought term insurance. The insurance contracts which had been transferred for valuable consideration were ordinary life policies. The term insurance contract which was then taken out was not the contract which was transferred. They were different contracts. Term insurance does not have any investment feature. It was merely payment for the risk for a term.

New policies came into existence (a) as a matter of fact; and (b) as a matter of law.

(a) As a matter of fact they were different contracts.

In at least one case the policy itself (R. 124) provided that if the premiums were not paid up and certain other options were not taken, that the company would put in force in lieu of that particular policy a non-participating paid-up term policy.

This paid-up term policy was put in force by the Company without any action on the part of the Insured *in lieu of* the old policy. The date of the policy was not to be 1924 (as was true with the contract transferred), but was to be the date to which the premiums had been paid, namely, July 29, 1939 (some four years after the original contract had been transferred); the policy was to be a non-participating paid-up term policy, not an ordinary life policy; the

amount was not changed; the provision for disability benefits was not included in the paid-up term policy as it had been in the ordinary life policy; there was no right to borrow money on the paid-up term policy as there had been in the ordinary life policy; the term of coverage was to be a specified term instead of for life. Surely as to this Prudential policy there was a new contract, one that came into being more than four years after the transfer to Securities and some months after the transfer to petitioner.

The factual situation in some of the policies may be slightly different but in principle the result is identical in each policy (save the Travelers' term policy). The term policy was for a definite term. There was new insurance and a new term each time a premium was paid.

(b) As a matter of law the policies transferred were not the policies collected on.

Basically in the case of each contract (other than the Travelers' term policy) the contracts transferred were ordinary life contracts and the contracts collected on were paid-up term policies. As a matter of law the term insurance contracts which taxpayer collected are different from the ordinary life contracts transferred to it.

> "Term insurance is essentially different from an ordinary life policy as it is based upon wholly different consideration."
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> 44 C.J.S. p. 487, Section 27(c).

In *Gans v. Aetna Life Insurance Co. of Hartford* (Sup. Ct. App. Div. 1914) 146 N.Y.S. 453, affirmed

(Ct. of Appeals N.Y. 1915) 108 N.E. 443, in holding that a straight life policy converted from a term policy by the exercise of an option contained therein was a new policy, the Court said:

> "Term insurance is essentially different, being insurance for the specified term only; the premium being calculated on a basis which provides for such deaths only as occur during the term. The premium paid is 'level' during the specified term only, and increases with each renewal term. The premium in the case of term insurance is considerably lower than in the case of straight life insurance, the premium in the former case carrying no reserve, being based upon a sort of 'pay as you go' theory."

A policy reinstated after lapse for nonpayment of premiums is a new contract and the computation of time in applying provisions for incontestability runs from the date of reinstatement rather than the date the policy was originally issued.

In this connection see the following cases:

New York Life Insurance Co. v. Seymour (C.C.A. 6th, 1930), 45 F. (2d) 47;

State Life Insurance Company v. Spencer, (C.C.A. 5th, 1933) 62 F. (2d) 640;

New York Life Insurance Company v. Odom, (C.C.A. 5th, 1937), 93 F. (2d) 641; and

Rosenthal et al. v. New York Life Ins. Company, (C.C.A. 8th, 1938), 99 F. (2d) 578.

So, in this case, the ordinary life insurance contracts lapsed because of the failure of petitioner to pay the premiums due in 1939; instead of being later

reinstated as in the above cases the respective insurance companies put into effect for petitioner's benefit a new kind of protection, a new insurance contract, namely, term insurance for a term computed for a period for which the cash surrender value paid therefor at rates based on decedent's then age.

B. THE PROCEEDS OF LIFE INSURANCE DO NOT COMPENSATE PETITIONER FOR THE LOSS IT SUSTAINED UPON THE DEATH OF ITS PRESIDENT AND CHIEF SHAREHOLDER.

The proceeds of the life insurance do not equal the loss suffered by petitioner resulting from decedent's death, including, but not limited to, the money actually paid out by petitioner to settle the controversies which grew out of the decedent's death.

Damages which a wife would recover for the wrongful death of her husband would not be income.

An award paid for the loss of a life is compensation for the loss and as such is not embraced in the general concept of the term income. The award is to restore the widow to substantially the same financial and economic status as she possessed prior to the death of her husband. This is done by the substitution of a sum of money for the life that was lost.[21]

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[21]Paraphrasing IT 2420 VII-2 CB 123; also see the language of the Supreme Court of the United States in *U. S. v. Supplee-Biddle Hardware Co.,* 265 U.S. 189, 68 L. Ed. 970 at page 975, 1 USTC par. 95, which holds that the insurance owned by a corporation on the life of its president who was a man of ability, energy and initiative was valid and not a wagering contract and that the company had an insurable interest in his life. "Life insurance in such a case is like that of fire and marine insurance,—a contract of indemnity. * * * It is a substitution of money value for something permanently lost, either in a house, a ship, or a life. * * *"

Decedent's death was a loss to petitioner. That cannot be denied. To measure it in dollars and cents is difficult, but not impossible. Such loss was much in excess of the net proceeds of the policies, i.e., in excess of $106,967.56.

Upon decedent's death, his widow was appointed administratrix of his estate.

His estate owned some 17,000 out of petitioner's 32,000 shares then outstanding. The widow owned some 5,000 of such shares. The widow threatened to liquidate petitioner. If accomplished, that would mean the utter destruction of petitioner. Negotiations to buy out her interest were commenced in the early autumn of 1941 and were about to reach fruition when the Japs attacked Pearl Harbor. (R. 85.) The settlement fell through because it was obvious that petitioner could not live under the deal if new cars were to go off the market. (R. 85.) This then seemed most likely. Litigation to remove petitioner's management was commenced by the widow before Christmas 1941. (R. 85.) This litigation was finally settled. The settlement agreement is in evidence as petitioner's Exhibit 15. (R. 197-270.)

This settlement agreement shows the following controversies between the widow and petitioner:

A. A dispute of petitioner's claim against decedent (R. 85) aggregating over $300,000.

B. A dispute as to the claim of the New York corporation which was one of petitioner's wholly owned subsidiaries. (R. 200.)

C. A controversy with respect to whether certain assets were owned by petitioner or the widow, or owned by the decedent at the time of his death. (R. 200.)

D. A controversy as to the extent of the family allowance to be received by the widow. (R. 201.)

E. A controversy as to whether decedent or petitioner owned the stock of the Detroit subsidiary. (R. 201.)

F. A controversy as to the removal of petitioner's Board of Directors. (R. 201 and 202.)

G. Litigation resulting in an injunction. (R. 202.)

It is obvious that the foregoing controversies might have well resulted in the termination of the license petitioner held from its supplier of motor vehicles and the destruction of petitioner through its liquidation. These controversies were no figment of the imagination. They were bitterly contested in actual Court litigation. The settlement agreement was made to save the petitioner. Pursuant to the agreement, the Woodside property valued at \$67,057.95 was transferred to Mrs. Waters. (R. 48.) Approximately \$355,000 was paid to the widow pursuant to the settlement agreement. (R. 86.) Of this amount approximately \$189,000 was paid for some 5,000 shares of petitioner's common stock owned by the widow. (R. 204.) \$141,000 was paid in full settlement of her interest in the controversies referred to in the agreement and for her interest in the estate (R. 205), and \$25,000 was paid to her as her family allowance pur-

suant to the guarantee. (R. 210.) Also as part of the settlement, the petitioner paid Mr. McGovern, the attorney for the widow, $22,500 (R. 86), and, subsequent to the settlement agreement, petitioner furnished in excess of $100,000 to the estate in order that the estate might be closed. (R. 86.) None of these payments would have been made had decedent lived. All of them arose out of the controversies existing between petitioner and the widow. For the $25,000 paid as family allowance and the $22,500 paid as attorney fee, petitioner received nothing other than the settlement. It is true that for the $330,000 petitioner ultimately received some of its own common stock. This, however, was an actual drain on the company's resources and is something that the company would not have paid out had it not been for decedent's death. It is an actual, unwanted, undesirable dimunition of assets.

It seems incontrovertible that, in a very genuine sense, the petitioner suffered an actual loss in dollars and cents paid out far in excess of the $106,000 which were the net proceeds of the insurance policies, and no part of the insurance proceeds should be included in petitioner's income for the purpose of federal income taxes, declared value excess profits taxes or excess profits taxes.

This brings us to our next point which is that the proceeds of life insurance are not income under the Sixteenth Amendment.

C. THE PROCEEDS OF THE LIFE INSURANCE ARE NOT INCOME UNDER THE SIXTEENTH AMENDMENT.

The question as to whether the proceeds of life insurance are income under the Sixteenth Amendment was before this Court in *U. S. v. Supplee-Biddle Hardware Company* (1925), 265 U.S. 189, 44 Sup. Ct. 546. The Court held it was not necessary to decide that question but did say "that proceeds of a life insurance policy paid on the death of the insured are not usually classed as income."

The Sixteenth Amendment is to be taken as written and is not to be extended beyond the meaning clearly indicated by the language used. (*Edwards v. Cuba Railroad Company* (1924), 268 U.S. 628, 45 Sup. Ct. 614.

In *Eisner v. Macomber* (1920), 252 U.S. 189, 40 Sup. Ct. 189, in holding that stock dividends were not income under the Sixteenth Amendment, although declared to be income by the Revenue Act of 1916, the Court said:

> "A proper regard for its genesis, as well as its very clear language, requires also that this Amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution, that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function, and is not to be overridden by Congress or disregarded by the courts.

"In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect it becomes essential to distinguish between what is and what is not 'income,' as the term is there used; and to apply the distinction, as cases arise, *according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate,* and within whose limitations alone that power can be lawfully exercised.

"* * * For the present purpose we require only a clear definition of the term 'income' as used in common speech, in order to determine its meaning in the Amendment; * * *"

In the hundred years before March 1, 1913, on that day and ever since, the proceeds of life insurance as used in common speech are not "income." In truth and in substance and without regard to form, the proceeds of the life insurance involved in this case were not income to taxpayer.

As we have before seen each policy (other than one term policy) lapsed in 1939; extended term insurance went into effect automatically. Disregarding form and looking at substance, the cash surrender value of each policy was obtained and used to buy term insurance. This term insurance was on petitioner's president and chief shareholder, a man of

ability, energy and initiative, and in whose life petitioner had an insurable interest. The proceeds of those policies are not income as used in common speech. In truth and in substance and without regard to form the proceeds of these policies were no more income to petitioner than are the proceeds of any policy taken out on anyone's life to the extent of the beneficiary's insurable interest therein. In truth and in substance and without regard to form, these proceeds are exempt from taxation.[22]

CONCLUSION.

In this brief we have demonstrated the following:

1. The Circuit Court of Appeals did have jurisdiction to review the determination of the Tax Court on a question arising under Section 721. Congress cannot vest the judicial power of the United States in the executive branch of the government.

2. Proceeds of life insurance are attributable to years prior to the year of death and collection; premiums, both for ordinary life insurance and for term policies, are not "solely an investment."

3. Such proceeds should not be included in gross income because

   (a) They are expressly exempted by Section 22(b)(1) of the Internal Revenue Code and the second quoted sentence of Section 22(b)(2);

[22]Section 22(b) (1) I.R.C.

(b) The policies collected on were not transferred for a valuable consideration, the policies so transferred having lapsed.

4. The proceeds of the life insurance here involved did not compensate petitioner for the loss which it sustained upon the death of its president and chief shareholder.

5. Such proceeds are not income under the Sixteenth Amendment to the Constitution.

We respectfully urge that this Court reverse the decision of the Circuit Court of Appeals.

Dated, San Francisco, California,
July 21, 1947.

Respectfully submitted,
EVERETT S. LAYMAN,
Attorney for Petitioner.

(Appendix Follows.)

Section 22(b)(1)

LIFE INSURANCE.—Amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income).

Section 22(b)(2)(A)

ANNUITIES, ETC. (A) IN GENERAL.—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this chapter or prior income tax laws in respect of such annuity equals the aggregate premiums or con-

sideration paid for such annuity. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph. The preceding sentence shall not apply in the case of such a transfer if such contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor[1]. * * *

[1]The last sentence of the 1942 amendment was not retroactive, as is the portion here included, and is omitted for that reason.

Section 721. ABNORMALTIES IN INCOME IN TAXABLE PERIOD.

(a) DEFINITIONS.—For the purposes of this section—

(1) ABNORMAL INCOME.—The term "abnormal income" means income of any class includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

(2) SEPARATE CLASSES OF INCOME.—Each of the following subparagraphs shall be held to describe a separate class of income:

(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

(B) Income constituting an amount payable under a contract the performance of which required more than 12 months; or

(C) Income resulting from exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes,

or any combination of the foregoing, extending over a period of more than 12 months; or

(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's accounting period or method of accounting; or

(E) In the case of a lessor of real property, income included in gross income for the taxable year by reason of the termination of the lease; or

(F) Income consisting of dividends on stock of foreign corporations, except foreign personal holding companies.

All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (F), inclusive, shall be subject to regulations prescribed by the Commissioner with the approval of the Secretary.

(3) NET ABNORMAL INCOME.—The term "net abnormal income" means the amount of the abnormal income less, under regulations prescribed by the Comsioner with the approval of the Secretary, (A) 125 per centum of the average amount of the gross income of the same class determined under paragraph (1), and (B) an amount which bears the same ratio to the amount of any direct costs or expenses, deductible in determining the normal-tax net income of the taxable year, through the expenditure of which such abnormal

income was in whole or in part derived as the excess of the amount of such abnormal income over 125 per centum of such average amount bears to the amount of such abnormal income.

(b) Amount Attributable to Other Years.—The amount of the net abnormal income that is attributable to any previous or future taxable year or years shall be determined under regulations prescribed by the Commissioner with the approval of the Secretary. In the case of amounts otherwise attributable to future taxable years, if the taxpayer either transfers substantially all its properties or distributes any property in complete liquidation, then there shall be attributable to the first taxable year in which such transfer or distribution occurs (or if such year is previous to the taxable year in which the abnormal income is includible in gross income, to such latter taxable year) all amounts so attributable to future taxable years not included in the gross income of a previous taxable year.

(c) Computation of Tax for Current Taxable Year.—The tax under this subchapter for the taxable year, in which the whole of such abnormal income would without regard to this section be includible, shall not exceed the sum of:

(1) The tax under this subchapter for such taxable year computed without the inclusion in gross income of the portion of the net abnormal income which is attributable to any other taxable year, and

(2) The aggregate of the increase in the tax under this subchapter for the taxable year (computed under paragraph (1)) and for each previous taxable year which would have resulted if, for each previous taxable year to which any portion of such net abnormal income is attributable, an amount equal to such portion had been included in the gross income for such previous taxable year.

(d) Computation of Tax for Future Taxable Year.—The amount of the net abnormal income attributable to any future taxable year shall, for the purposes of this subchapter, be included in the gross income for such taxable year.

(1) The tax under this subchapter for such future taxable year shall not exceed the sum of—

(A) the tax under this subchapter for such future taxable year computed without the inclusion in gross income of the portion of such net abnormal income which is attributable to such year, and

(B) the decrease in the tax under this subchapter for the previous taxable year in which the whole of such abnormal income would, without regard to this section, be includible which resulted by reason of the computation of such tax for such previous taxable year under the provisions of subsection (c); but the amount of such decrease shall be diminished by the aggregate of the increases in the tax under this subchapter for

the future taxable year as computed under subparagraph (A) and for the taxable years intervening between such previous taxable year and such future taxable year which have resulted because of the inclusion of the portions of such net abnormal income attributable to such intervening years in the gross income for such intervening years.

(2) If, in the application of subsection (c), net abnormal income from more than one taxable year is attributable to any future taxable year, paragraph (1) of this subsection shall be applied with respect to such future taxable year in the order of the taxable years from which the net abnormal income is attributable beginning with the earliest, as if the portion of the net abnormal income from each such year was the only amount so attributable to such future taxable year, and (except in the case of the portion for the earliest previous taxable year) as if the tax under this subchapter for the future taxable year was the tax determined under paragraph (1) with respect to the portion for the next earlier previous taxable year.

(3) If in the application of paragraph (1) to any future taxable year it is determined that the decrease in tax computed under paragraph (1) (B) with respect to the net abnormal income, a portion of which is included in the gross income for the future taxable year, does not exceed the aggregate of the increases in tax computed under paragraph (1) (B) with respect to such net abnormal income, then the portions

of such net abnormal income attributable to taxable years subsequent to such future taxable year shall not be included in the gross income for such subsequent taxable years. For the purpose of computing the tax under this subchapter for a taxable year subsequent to the future taxable year, the portion of net abnormal income attributable to the future taxable year shall not be included in the gross income for such future taxable year to the extent that the inclusion of such portion of net abnormal income in the gross income for such future taxable year did not result in an increase in tax for such future taxable year by reason of the provisions of paragraph (1).

(e) Application of Section.—This section shall be applied only for the purpose of computing the tax under this subchapter as provided in subsections (c) and (d), and shall have no effect upon the computation of base period net income. For the purposes of subsections (c) and (d)—

(1) Net abnormal income means the aggregate of the net abnormal income of all classes for one taxable year.

(2) Under regulations prescribed by the Commissioner with the approval of the Secretary, the tax under this sub-chapter for previous taxable years shall be computed as if the portions of net abnormal income for each previous taxable year for which the tax was computed under this section were included in the gross income for the other previous taxable years to which such portions were attributable.

(3) If both subsections (c) and (d) are applicable to any current taxable year, subsection (d) shall be applied without regard to subsection (c), and subsection (c) shall be applied as if the tax under this subchapter, except for subsection (c), was the tax computed under subsection (d) and as if the gross income and the other amounts necessary to determine the adjusted excess profits net income were those amounts which would result in the tax computed under subsection (d).

(f) Abnormal Income from Exploration, Etc.—If by reason of taking into account, in determining constructive average base period net income under Section 722, exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months, such constructive average base period net income is higher than it would be without such taking into account, only such portion of the income in the taxable year resulting from such activity which is of a class described in subsection (a) (2) (C) as is attributable to another taxable year under this subchapter shall be deemed attributable to a year other than the taxable year.

SECTION 30.721-3. AMOUNT ATTRIBUTABLE TO OTHER YEARS.—The mere fact that an item includable in gross income is of a class abnormal either in kind or in amount does not result in the exclusion of any part of such item from excess profits net income. It is necessary that the item be found attributable under these regulations in whole or in part to other taxable years. Only that portion of the item which is found to be attributable to other years may be excluded from the gross income of the taxpayer for the year for which the excess profits tax is being computed.

Items of net abnormal income are to be attributed to other years in the light of the events in which such items had their origin, and only in such amounts as are reasonable in the light of such events. To the extent that any items of net abnormal income in the taxable year are the result of high prices, low operating costs, or increased physical volume of sales due to increased demand for or decreased competition in the type of product sold by the taxpayer, such items shall not be attributed to other taxable years. Thus, no portion of an item is to be attributed to other years if such item is of a class of income which is in excess of 125 per cent of the average income of the same class for the four previous taxable years solely because of an improvement in business conditions. In attributing items of net abnormal income to other years, particular attention must be paid to changes in those years in the factors which determined the amount of such income, such as changes in prices,

amount of production, and demand for the product. No portion of an item of net abnormal income is to be attributed to any previous year solely by reason of an investment by the taxpayer in assets, tangible or intangible, employed in or contributing to the production of such income.

Section 722. GENERAL RELIEF—CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME.

(a) GENERAL RULE.—In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. In determining such constructive average base period net income, no regard shall be had to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayers generally occurring or existing after December 31, 1939, except that in the cases described in the last sentence of section 722 (b) (4) and in section 722 (c), regard shall be had to the change in the character of the business under section 722(b)(4) or the nature of the taxpayer and the character of its business under section 722(c) to the extent necessary to establish the normal earnings to be used as the constructive average base period net income.

(b) TAXPAYERS USING AVERAGE EARNINGS METHOD.—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer

entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because—

(1) in one or more taxable years in the base period normal production, output, or operation was interrupted or diminished because of the occurrence, either immediately prior to, or during the base period, of events unusual and peculiar in the experience of such taxpayer,

(2) the business of the taxpayer was depressed in the base period because of temporary economic circumstances unusual in the case of such taxpayer or because of the fact that an industry of which such taxpayer was a member was depressed by reason of temporary economic events unusual in the case of such industry,

(3) the business of the taxpayer was depressed in the base period by reason of conditions generally prevailing in an industry of which the taxpayer was a member, subjecting such taxpayer to

(A) a profits cycle differing materially in length and amplitude from the general business cycle, or

(B) sporadic and intermittent periods of high production and profits, and such periods are inadequately represented in the base period,

(4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average

base period net income does not reflect the normal operation for the entire base period of the business. If the business of the taxpayer did not reach by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time. For the purposes of this subparagraph, the term "change in the character of the business" includes a change in the operation or management of the business, a difference in the products or services furnished, a difference in the capacity for production or operation, a difference in the ratio of nonborrowed capital to total capital, and the acquisition before January 1, 1940, of all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or diminished. Any change in the capacity for production or operation of the business consummated during any taxable year ending after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940, or any acquisition before May 31, 1941, from a competitor engaged in the dissemination of information through the public press, of substantially all the assets of such competitor employed in such business with the result that competition between the taxpayer and the competitor existing before January 1, 1940, was eliminated, shall be deemed to be a change on December 31, 1939, in the character of the business, or

(5) of any other factor affecting the taxpayer's business which may reasonably be considered as resulting in an inadequate standard of normal earnings during the base period and the application of this section to the taxpayer would not be inconsistent with the principles underlying the provisions of this subsection, and with the conditions and limitations enumerated therein.

(c) INVESTED CAPITAL CORPORATIONS, ETC.—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer, not entitled to use the excess profits credit based on income pursuant to section 713, if the excess profits credit based on invested capital is an inadequate standard for determining excess profits, because—

(1) the business of the taxpayer is of a class in which intangible assets not includible in invested capital under section 718 make important contributions to income,

(2) the business of the taxpayer is of a class in which capital is not an important income-producing factor, or

(3) the invested capital of the taxpayer is abnormally low.

In such case for the purposes of this subchapter, such taxpayer shall be considered to be entitled to use the excess profits credit based on income, using the constructive average base period net income determined under subsection (a). For the purposes of sec-

tion 713(g) and section 743, the beginning of the taxpayer's first taxable year under this subchapter shall be considered to be that date after which capital additions and capital reductions were not taken into account for the purposes of this subsection.

(d) APPLICATION FOR RELIEF UNDER THIS SECTION.—The taxpayer shall compute its tax, file its return, and pay the tax shown on its return under this subchapter without the application of this section, except as provided in section 710(a)(5). The benefits of this section shall not be allowed unless the taxpayer within the period of time prescribed by section 322 and subject to the limitation as to amount of credit or refund prescribed in such section makes application therefor in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribe the extent to which the limitations prescribed by this subsection may be waived for the purpose of determining the tax under this subchapter for a subsequent taxable year.

(e) RULES FOR APPLICATION OF SECTION.—For the purposes of this section—

(1) the tax imposed by this subchapter shall be the tax before the allowance of the foreign tax credit pursuant to section 729(c) and (d);

(2) in the case of a taxpayer, the average base period net income of which is computed under Supplement A, for the period for which the income of any other person is included in the computation of the average base period net income of the taxpayer, the taxpayer shall be treated as if such other person's business were a part of the business of the taxpayer.

(f) MINING CORPORATIONS.—In the case of a taxpayer to which section 711 (a) (1) (I) or section 711 (a) (2) (K) applies, if its constructive average base period net income is established under this section, there shall also be determined a fair and just amount to be used as normal output and normal unit profit for the purposes of section 735.

(g) The Commissioner shall compile for each fiscal year beginning after June 30, 1941, by internal revenue districts, and alphabetically arranged, all cases in which relief has been allowed during such year under the provisions of this section by the Commissioner and by The Tax Court of the United States, as the case may be. Such compilation shall contain the name and address of each taxpayer to which relief has been so allowed, the business in which the taxpayer is engaged, the amount of the excess profits credit before such allowance, the increase in such credit claimed, the increase in such credit allowed, and the amount of the gross reduction in the tax under this subchapter and of the gross increase in the tax under Chapter 1, which results from the operation of this section. In the case of relief allowed by

The Tax Court of the United States, the Commissioner shall also set forth the data previously reported under this subsection with respect to relief previously allowed in such case by the Commissioner. Such compilation shall be published in the Federal Register.

SECTION 732(c).

FINALITY OF DETERMINATION.—If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711(b)(1)(H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Board.

SECTION 301 OF THE REVENUE ACT OF 1918.

SEC. 301. TAX RATES.—(a) That in lieu of the tax imposed by Title II of the Revenue Act of 1917, but in addition to the other taxes imposed by this Act, there shall be levied, collected, and paid for the taxable year 1918 upon the net income of every corporation a tax equal to the sum of the following:

First Bracket.

30 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

Second Bracket.

65 per centum of the amount of the net income in excess of 20 per centum of the invested capital;

Third Bracket.

The sum, if any, by which 80 per centum of the amount of the net income in excess of the war-profits credit (determined under section 311) exceeds the amount of the tax computed under the first and second brackets.

(b) For the taxable year 1919 and each taxable year thereafter there shall be levied, collected, and paid upon the net income of every corporation (except corporations taxable under subdivision (c) of this section) a tax equal to the sum of the following:

First Bracket.

20 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

Second Bracket.

40 per centum of the amount of the net income in excess of 20 per centum of the invested capital.

(c) For the taxable year 1919 and each taxable year thereafter there shall be levied, collected, and paid upon the net income of every corporation which derives in such year a net income of more than $10,000 from any Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, a tax equal to the sum of the following:

(1) Such a portion of a tax computed at the rates specified in subdivision (a) as the part of the net income attributable to such Government contract or contracts bears to the entire net income. In computing such tax the excess-profits credit and the war-profits credit applicable to the taxable year shall be used;

(2) Such a portion of a tax computed at the rates specified in subdivision (b) as the part of the net income not attributable to such Government contract or contracts bears to the entire net income.

For the purpose of determining the part of the net income attributable to such Government contract or

contracts, the proper apportionment and allocation of the deductions with respect to gross income derived from such Government contract or contracts and from other sources, respectively, shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(d) In any case where the full amount of the excess-profit credit is not allowed under the first bracket of subdivision (a) or (b), by reason of the fact that such credit is in excess of 20 per centum of the invested capital, the part not so allowed shall be deducted from the amount in the second bracket.

(e) For the purposes of the Act approved March 21, 1918, entitled "an Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," the tax imposed by this title shall be treated as levied by an Act in amendment of Title II of the Revenue Act of 1917.

Section 327 of the Revenue Act of 1918.

Sec. 327. Inability of Commissioner to Determine Invested Capital; Foreign Corporations.—That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) in the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or

more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

Section 328 of the Revenue Act of 1918.

Sec. 328. Computation and Record of Tax Under Preceding Section.—(a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

In cases in which the tax is to be computed under this section, if the tax as computed without the bene-

fit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installment shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of $\frac{1}{2}$ of 1 per centum per month on such excess from the time the installment was due.

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.